STERISYSTEMS LTD.

ANNUAL REPORT 1976

Sterisystems Ltd.

BOARD OF DIRECTORS

Peter A. Allen, TORONTO, VICE PRESIDENT, LITTLE LONG LAC GOLD MINES LTD.

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*†Michael J. Needham, TORONTO, PRESIDENT AND CHIEF EXECUTIVE OFFICER, STERISYSTEMS LTD.

†Albert B. Ormsby, TORONTO, VICE-PRESIDENT, ANMERCOSA VENTURES LTD.

*Maurice Parent, MONTREAL, PRESIDENT, FAMILEX PRODUCTS LTD.

Donald C. Webster, TORONTO, PRESIDENT, HELIX INVESTMENTS LIMITED

(*Members of the Executive Committee †Members of the Audit Committee)

OFFICERS

Donald C. Webster, CHAIRMAN OF THE BOARD

Michael J. Needham, PRESIDENT AND CHIEF EXECUTIVE OFFICER

A. Drizen, VICE PRESIDENT

John W. Hearn, VICE PRESIDENT

Douglas H. Last, VICE PRESIDENT

Harold M. Pipher, VICE PRESIDENT

J. Michael Usatis, VICE PRESIDENT

AUDITORS

Thorne Riddell & Co., Toronto

TRANSFER AGENT AND REGISTRAR

The Canada Trust Company, Toronto

STERISYSTEMS LTD.

Head Office 47 BAYWOOD ROAD, REXDALE (TORONTO), ONTARIO M9V 3Y9

375 LEBEAU BOULEVARD, VILLE ST-LAURENT (MONTREAL), QUEBEC, H4N 1S2

7964 ALDERBRIDGE WAY, RICHMOND (VANCOUVER), BRITISH COLUMBIA, V6X 2A6

WEBBER PHARMACEUTICALS LIMITED

14 RONSON DRIVE, REXDALE (TORONTO), ONTARIO, M9W 1B2

STERIVET LABORATORIES LIMITED

670 HARDWICK ROAD, BOLTON, ONTARIO

This annual report covers the ninth year of operations for Sterisystems Ltd., its fifth year as a public company.Sterisystems Ltd. operates nationally in Canada in the health care field through four divisions—Hospital Services Division, engaged in hospital patient television rental, hospital communication systems and in-hospital flower sales; Medical Products Division, distributing electronic medical and surgical instruments; Webber Pharmaceuticals Division, Canada's original and leading manufacturer of vitamin E products; and Sterivet Laboratories, manufacture and distribution of veterinary pharmaceuticals designed specifically to serve the equine market.

To The Shareholders

1976 was an extremely difficult year for your Company. The profitability of all the Company's divisions was threatened by rising costs, disappointing revenue growth and adverse changes in several of our marketplaces. As a result, after making $878,000 after-tax profit on $9.0 million sales in 1975, the Company lost $526,000 on $9.9 million sales in 1976.

In retrospect, it is clear the Company was slow to react to certain of these adverse market factors. When the problems were fully identified in the Fall, the strains of readjusting quickly were felt throughout the Company. A number of major changes were made among the management and staff; one operating division was closed and others are being reorganized. A major continuing effort is being made to reduce expenses and re-establish profitable operations.

In the 1st quarter of 1977 your Company returned to profitability, albeit at a level lower than that achieved in previous years. Problems still remain and are reflected in disappointing human pharmaceutical sales and some weakening gross margins. However with employee morale strengthening and new areas of growth opening up, the Company should operate profitably throughout 1977.

Financial Review

In 1976 revenues increased 10% from $9,049,127 in 1975 to $9,857,976, but a loss of $526,000 was recorded compared to a $878,000 profit in 1975. Earnings per share declined from .58 in 1975 to a .37¢ loss in 1976.

The major problem was the enormous increase in the cost of sales from $6.3 million to $8.9 million, an increase of 41%. This cost escalation was primarily attributable to rapidly increasing labour costs in the Hospital Services Division. Furthermore, sales, service and administrative expenses in all divisions increased faster than sales growth.

In 1976 the Company made certain changes in accounting policies as explained in the Notes to the Consolidated Financial Statements. If these changes had not been made, the loss for the current year would have been reduced by approximately $230,000. Furthermore, the Company adopted more conservative accounting procedures which added to the losses in the 4th quarter.

Despite the profit collapse, the Balance Sheet and Working Capital strengthened during the year as a result of a positive operating cash flow and long-term financing arranged with Barclays Canada Limited. Barclays' continuing strong support has been a major factor in the Company's recovery.

Operating Highlights

On December 29, 1976 your Company purchased the assets of Wells Television Limited, a company operating a T.V. rental business in Canada. During 1977 Well's operations will be merged into those of Sterisystems and with the cooperation of the hospital administrations involved, a promising start has been made.

Sterivet Laboratories increased its sales penetration in Canada and opened a U.S. office in late 1976. Sterivet's products enjoyed good initial acceptance in the U.S. and we are hopeful that a strong business in equine drugs can be built in the next few years.

Diagnostic Data Inc. continued to make good progress in its clinical trial program in the United States on the patented arthritic drug, ORGOTEIN. Your Company is placing increased emphasis on establishing a clinical trial program in Canada aimed at early approval for this drug.

The Steri-Med division made satisfactory sales progress in 1976. We will continue to build around this division which represents in Canada a number of fine medical equipment manufacturers.

Policy

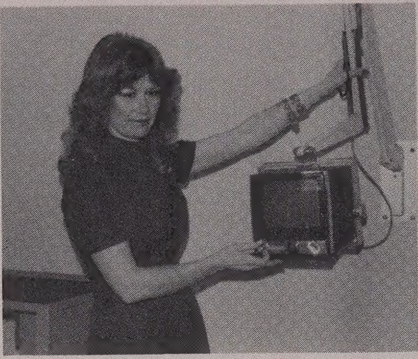
Your Company is committed to providing high quality service to hospital patients. We endeavour to maintain our systems at the highest level, a level demanded of us by the nature of our working in a hospital environment. We have never shirked this responsibility, nor will we. The updating and maintaining of our 300 installations is an expensive task and can only be supported in these inflationary times by improving our revenue base. This was the reason for our acquiring Wells T.V. and for our constant efforts to increase our viewing audience. We have endeavoured to maintain our daily rental rates to the minimum, commensurate with reasonable returns on investment, as evidenced by our keeping at 2% the average annual increases between 1970 and 1975. However, the continuing high inflation rates being experienced in Canada are now forcing us to adjust our daily rental rates in order to provide the quality service to which the Company is committed.

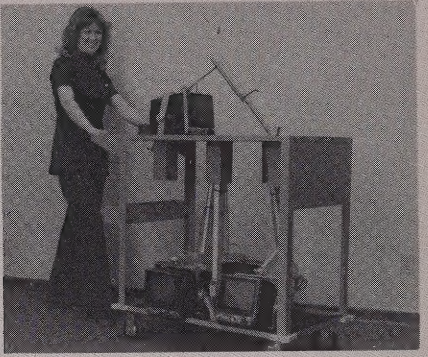
Personnel

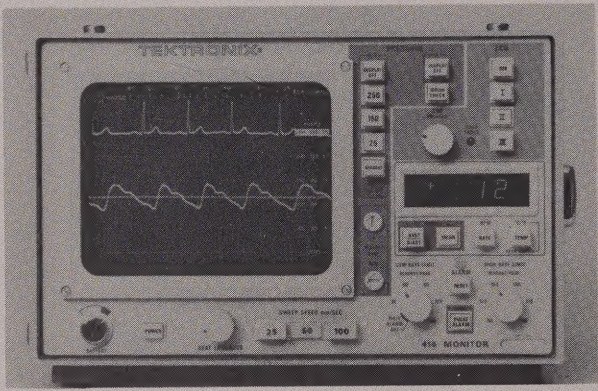
In November Paul Jeffrey, a founder of the Company and its President since incorporation, resigned for personal reasons. It is not exaggerating to say that without his contribution, there would be no Sterisystems. The Board joins me in extending to Paul Jeffrey its best wishes for his future success. Michael J. Needham, a director and a previous officer of the Company, was appointed President on an interim basis. The Board expects the appointment of a permanent President to be made in 1977.

On behalf of the Board of Directors, I should like to thank all associated with the Company, particularly its employees and shareholders, for their efforts and loyalty during the past few difficult months. With their positive support, your Company should soon regain its past vigour and profitability.

MICHAEL J. NEEDHAM
President



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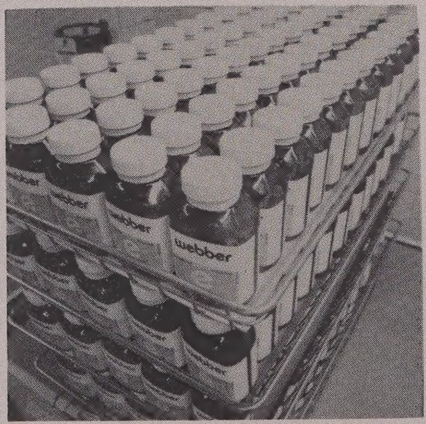
MONITOR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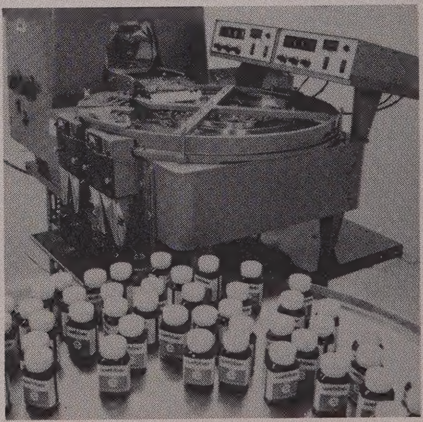
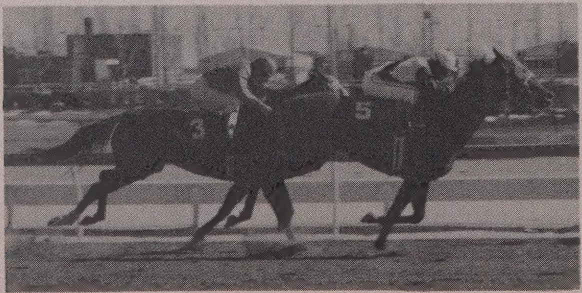




Results in brief	1976	1975
Revenue	$ 9,858,000	$ 9,049,000
Cash flow	$ 518,000	$ 2,182,000
Profit (loss) for the year	$ (526,000)	$ 878,000
Earnings (loss) per share—fully diluted	$ (0.37)	$ 0.60
Common shares outstanding at year-end	1,407,703	1,402,853
Shareholders' equity	$ 4,208,000	$ 4,722,000
Total assets	$11,655,000	$11,562,000

Hospital Services Division

The division experienced a softening trend in the patient television rental business in 1976. Specifically, budget restraints in hospitals forced accelerated patient turnover, thereby reducing bed days available for the renting of television. This, combined with increased operating costs, led to an operating loss for the division in 1976. However, the hospitals that we service have been responsive to our request to adjust rental rates and the division should return to profitability in 1977.

On December 29, 1976, Sterisystems acquired Wells Television Limited. The integration of the Wells hospitals into our present operations is being accomplished with a minimum of additional operating expense and will make a positive contribution to the future success of the division.

Medical Products Division

1976 will be recorded as one of the most difficult years in the Canadian Health Care Industry due to labour problems, hospital closures and budgetary restrictions.

The Division continued to promote its image as a medical specialty company selling and servicing high technology equipment and consumables to the critical care areas of the hospital. During 1977, efforts will be made to secure new product lines which will complement our existing range. In addition, more emphasis will be placed on consumables, which will provide a stable base upon which future growth will be planned.

New products will continue to be developed by our existing manufacturers who are the leaders in their respective fields of monitoring, diagnostics and electro-surgery equipment. In addition, the division distributes infusion pumps for accurate administration of intravenous.

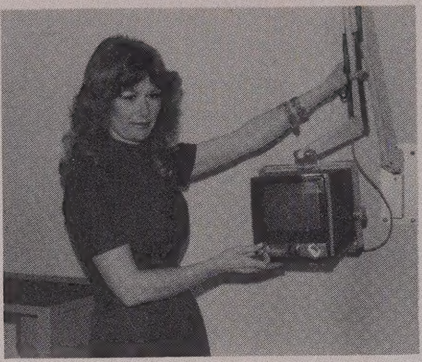
The Division has a mature, experienced sales force which has demonstrated a higher degree of productivity throughout 1976. This expertise, plus the addition of sales support staff and marketing aids will assure growth for the Division in 1977.

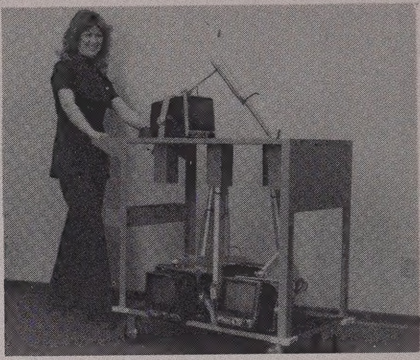
Webber Pharmaceuticals

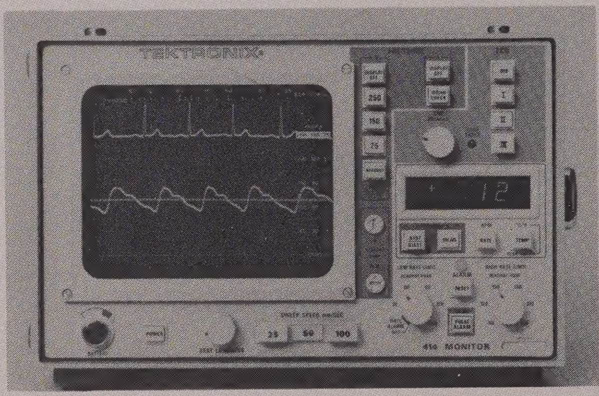
Webber Pharmaceuticals experienced little growth in 1976, principally due to softness in the Vitamin market. The division's new "Timed Release Vitamin C" was well accepted at the physician and consumer level. The division continues to be committed to the introduction of new drugs and a new bronchodilator "Dilin" has been successfully launched in the first quarter of 1977. Development is proceeding on a number of other new drugs, including Orgotein which continues in clinical trial. During the next few years, these developments will enhance the opportunities for significant growth in the division.

Sterivet Laboratories

1976 was an active year for Sterivet Laboratories. Volume increased 70% as a result of strong growth of both feed supplements and the basic line of injectible products. The new product development program resulted in the introduction of two new products, including an organic electrolyte feed supplement which has been extremely well received. The Company also expanded its operation into the large U.S. market and opened offices in Cleveland, Ohio in October. Initial start-up costs produced a loss for the year but there is every expectation that this operation will contribute significantly to sales and profits in the coming years.



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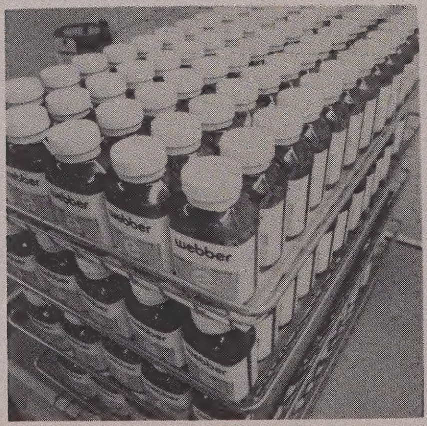
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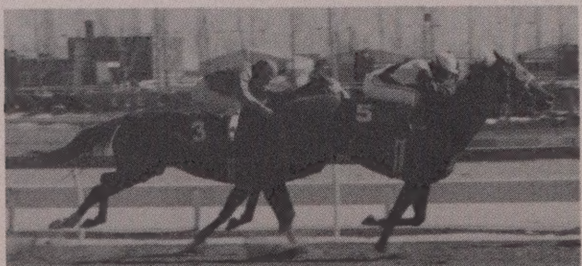
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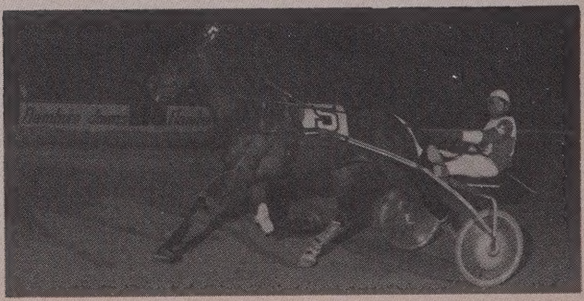

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Sterisystems Ltd.
and subsidiary companies.

CONSOLIDATED STATEMENT OF INCOME	52 weeks ended December 31, 1976	53 weeks ended January 2, 1976
Revenue	$9,857,976	$9,049,127
Cost of sales and expenses other than undernoted	8,892,486	6,338,986
Income before the following items	965,490	2,710,141
Employees' termination costs	230,000	
Interest on long term debt	193,792	144,687
Other interest	121,257	131,057
Depreciation	1,135,523	810,332
Amortization	182,243	34,830
	1,862,815	1,120,906
	(897,325)	1,589,235
Dividend income		10,000
Income (loss) before income taxes and extraordinary item	(897,325)	1,599,235
Income taxes (note 11)		
Current (recoverable)	(97,950)	231,135
Deferred (reduction)	(273,450)	545,715
	(371,400)	776,850
Income (loss) before extraordinary item	(525,925)	822,385
Gain on sale of investment net of income taxes of $18,000		55,558
NET INCOME (LOSS) (note 2)	$ (525,925)	$ 877,943
EARNINGS PER SHARE		
Income (loss) before extraordinary item	$(.37)	$.58
Net income (loss)	$(.37)	$.63

CONSOLIDATED STATEMENT OF DEFICIT	52 weeks ended December 31, 1976	53 weeks ended January 2, 1976
DEFICIT AT BEGINNING OF YEAR	$ 495,808	$1,373,751
Net income (loss)	(525,925)	877,943
DEFICIT AT END OF YEAR	$1,021,733	$ 495,808

Sterisystems Ltd.
and subsidiary companies.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION	52 weeks ended December 31, 1976	53 weeks ended January 2, 1976
WORKING CAPITAL DERIVED FROM		
Operations	$ 518,391	$2,182,108
Increase in long term debt	3,270,000	550,000
Reduction in instalment receivables	30,744	
Reduction in advance to employees	54,303	
Issue of common shares	11,750	118,575
Proceeds on disposal of fixed assets	1,000	8,255
Increase in deferred income		83,832
Proceeds on disposal of investment in shares		75,000
	3,886,188	3,017,770
WORKING CAPITAL APPLIED TO		
Additions to fixed assets (including acquisitions of $608,602—note 4)	1,171,148	848,494
Long term debt repaid or included in current liabilities	1,493,951	716,778
Purchase of goodwill	504,815	539,600
Sales licences	110,000	142,680
Research and development	136,338	95,226
Decrease in deferred income	4,720	
Increase in instalment receivables		69,833
Increase in advance to employees, less current portion		12,640
	3,420,972	2,425,251
INCREASE IN WORKING CAPITAL POSITION	465,216	592,519
WORKING CAPITAL DEFICIENCY AT BEGINNING OF YEAR	695	593,214
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ 464,521	$ (695)

Sterisystems Ltd.
(Incorporated under the laws of Canada)
and subsidiary companies.

CONSOLIDATED BALANCE SHEET ASSETS	December 31, 1976	January 2, 1976
CURRENT ASSETS		
Cash	$ 33,620	$ 86,531
Accounts receivable	1,130,734	1,211,992
Notes receivable	48,063	
Inventory	1,031,191	1,426,541
Income taxes recoverable	99,225	
Prepaid expenses	86,463	129,908
	2,429,296	2,854,972
ADVANCE TO EMPLOYEES, less current portion (note 8)	23,337	77,640
INSTALMENTS RECEIVABLES, less current portion	166,755	197,499
FIXED ASSETS (note 3)	7,607,645	7,573,020
GOODWILL	995,205	526,030
PATENT LICENCES	85,500	95,000
SALES LICENCES AND DEFERRED RESEARCH AND DEVELOPMENT EXPENDITURES (note 5)	347,141	237,906
	$11,654,879	$11,562,067
CURRENT LIABILITIES		
Bank advances (note 6)	$ 340,234	$ 684,708
Accounts payable and accrued liabilities	1,203,512	1,212,404
Income taxes payable		254,460
Current portion of long term debt	421,029	704,095
	1,964,775	2,855,667
LONG TERM DEBT (note 7)	3,830,000	2,053,951
DEFERRED INCOME TAXES	1,538,133	1,811,583
DEFERRED INCOME	113,749	118,469
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (notes 7, 8 and 9) Authorized 3,000,000 Common shares without par value Issued 1,407,703 Common shares (January 2, 1976, 1,402,853 shares)	5,229,955	5,218,205
DEFICIT	1,021,733	495,808
	4,208,222	4,722,397
	$11,654,879	$11,562,067

Approved by the Board, Michael J. Needham, DIRECTOR, Michel M. Lessard, DIRECTOR

1. SUMMARY OF ACCOUNTING POLICIES

(a) Principles of consolidation
The consolidated financial statements include the accounts of the company and all subsidiary companies.

(b) Inventory
Inventory is valued at the lower of cost and net realizable value.

(c) Revenue
Revenue in the financial statements includes television rentals in hospitals, equipment sales, flower sales and pharmaceutical sales.

(d) Fixed assets (notes 2 and 3)
Included in the cost of television sets, rental equipment and hospital installations in service is the direct cost of the equipment, materials, labour, factory overhead and prior to 1976, an applicable share of general and administrative overhead.

(e) Depreciation policy (notes 2 and 3)
Depreciation is provided on a straight line basis as follows:

Cost of hospital installations	
Original	10 years
Subsequent	3 years
Television sets	
Black and white	10 years
Colour	7 years
Other equipment	3 to 10 years
Leasehold improvements	term of lease

No depreciation is provided on television sets and materials for use in future hospital installations until such time as these items are in use.

(f) Goodwill (note 2)
Goodwill is stated at cost less amortization, provided on a straight line basis over fifteen years.

(g) Patent licences (note 2)
Patent licences are stated at cost less amortization, provided on a straight line basis over ten years.

(h) Deferred research and development
All research and development costs are capitalized and amortized on a straight line basis over three years. Should any project in the opinion of management cease to be viable, all unamortized costs related to that project will be written off in that year.

(i) Sales licences
Sales licences are recorded at cost and are to be amortized on a straight line basis over five years, commencing with the year ending December 30, 1977.

(j) Deferred income
The company recognizes income on long term lease contracts over the length of the lease.

2. CHANGES IN ACCOUNTING POLICIES

Commencing with the current year, the company ceased to capitalize general and administrative overheads in installations. In addition, the company increased the rates of depreciation and amortization on hospital installations, goodwill and patent licences.

If these changes had not been made, the loss for the current year would have been reduced by approximately $230,000.

3. FIXED ASSETS

	December 31, 1976 Cost	December 31, 1976 Accumulated depreciation	Net	January 2, 1976 Net
Television sets and materials for use in future hospital installations	$ 57,026		$ 57,026	$ 158,274
Television sets, rental equipment and hospital installations in service	10,626,451	$ 3,450,666	7,175,785	7,049,289
Other equipment	581,519	248,127	333,392	306,800
Leasehold improvements	158,995	117,553	41,442	58,657
	$11,423,991	$ 3,816,346	$ 7,607,645	$ 7,573,020

4. ACQUISITION OF BUSINESS

Effective December 29, 1976, the company purchased certain assets and assumed certain liabilities of Wells Television Limited. The transaction has been accounted for on the purchase method with the results of operations included in these financial statements from the date of acquisition. The acquisition equation is as follows:

Net assets acquired, at assigned value	
Current assets	$ 68,255
Fixed assets	608,602
	676,857
Current liabilities	194,929
	481,928
Goodwill	504,815
Total purchase price	$986,743
Consideration given	
Cash	$ 16,743
Issue of promissory note (note 7)	970,000
	$986,743

5. SALES LICENCES AND DEFERRED RESEARCH AND DEVELOPMENT EXPENDITURES

In January 1975, the company entered into agreements with an American company to manufacture a drug known generically as "Orgotein" which will be sold in Canada, Japan and certain other markets. In addition, the company has been granted the exclusive licence to sell the drug in Canada.

The terms of the agreements require the company to undertake sufficient testing to obtain the approval of the Health Protection Branch, Ottawa, prior to marketing the drug. The costs related to this program are estimated to be approximately $400,000.

The company may discontinue the further development of this program at any time. However, if it proceeds, it will then share equally the expected expenditures of up to $7,000,000 for patents and manufacturing facilities in return for a 50% interest in a manufacturing venture.

The amount shown as sales licences and deferred research and development expenditures consists of the following:

	December 31, 1976	January 2, 1976
"Orgotein"—licences	$252,680	$142,680
—research and development	52,565	72,226
	305,245	214,906
Other projects—research and development	41,896	23,000
	$347,141	$237,906

The licences are stated at cost and the deferred research and development at cost less amortization (note 1(h) and (i)).

6. BANK ADVANCES

Bank advances are secured by a first charge on the company's accounts receivable.

7. LONG TERM DEBT	December 31, 1976	January 2, 1976
(a) Registered Secured Demand Debenture with Barclays Canada Limited at the rate of 1¾%, above the lender's cost of funds, evidenced by a demand note, with repayments of $42,000 monthly, commencing January 1, 1978 (note (a))	$2,300,000	
(b) 10% Promissory Note payable in equal quarterly instalments of $40,417 commencing January 1, 1978 and secured by a registered collateral debenture (note 4 and note (b))	970,000	

(c) Term Bank Loan at the rate of 1½% above bank's prime rate, payable $28,333 monthly (note (c))		$1,286,667
(d) Term Bank Loan at the rate of 1½% above bank's prime rate, payable $20,000 annually		42,000
(e) Non-interest Bearing Note, payable $350,000 annually and guaranteed under the Registered Secured Demand Debenture (note (a))	700,000	1,050,000
(f) 6% Promissory Note, payable $70,000 annually commencing June 27, 1976 with annual increase of 1% in the interest rate	280,000	350,000
(g) Sundry loans at varying rates and maturities	1,029	29,379
	4,251,029	2,758,046
Less amount included in current liabilities	421,029	704,095
	$3,830,000	$2,053,951

(a) The Registered Secured Demand Debenture is for $3,000,000 and is secured by a fixed and floating charge over the whole of the company's undertakings and includes a specific pledge of the shares of subsidiary companies.

This Debenture is secondary to the bank and the Registered Collateral Debenture as set out in (b) and (c) below.

In addition to certain other conditions, the company may not declare or pay dividends on its common shares without the prior consent of the Registered Secured Demand Debenture holder.

(b) 10% Promissory note is secured by a Registered Collateral Debenture and has a fixed and specific charge on the rental television sets and related equipment on location purchased from Wells Television Limited on December 29, 1976.

(c) The company's bankers have a first charge on the company's accounts receivables.

8. CAPITAL STOCK

At December 31, 1976, options on 37,200 common shares were outstanding exercisable at $2.50 to $3.47 per share for periods up to 1981. During the current year 4,850 shares were issued for cash of $11,750.

The employee advances related to amounts advanced in prior years under the executive stock purchase plan.

Subsequent to the year end, amendments to certain aspects of the executive stock purchase plan were made which are subject to shareholders' approval.

9. ANTI-INFLATION ACT

The company is subject to that portion of the Anti-Inflation Act which provides as from October 14, 1975 for the restraint of dividends in Canada.

10. LONG TERM LEASES

The company rents buildings and leases equipment under long term leases which expire at various dates to November 30, 1979, the annual rental for which is approximately $95,000.

11. INCOME TAXES

For the year ended December 31, 1976, an American subsidiary of the company had a loss of approximately $82,000. The tax effect of this loss has not been recorded in the 1976 accounts. This loss carried forward is available to reduce future income for tax purposes until 1981.

12. OTHER STATUTORY INFORMATION

During the year the company had seven directors whose aggregate remuneration as directors was $16,800. There were eight officers whose aggregate remuneration as officers was $510,000 including $230,000 of termination cost. Two officers were also directors. In addition, two officers of the parent company received $4,500 as directors of the subsidiary company.

13. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the financial statement presentation adopted for the 52 weeks ended December 31, 1976.

Sterisystems Ltd.
and subsidiary companies

AUDITOR'S REPORT
to the Shareholders of Sterisystems Ltd.

We have examined the consolidated balance sheet of Sterisystems Ltd. as at December 31, 1976 and the consolidated statements of income, deficit and changes in financial position for the 52 weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1976 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles which, except for the change in accounting policies as set out in note 2, have been applied on a basis consistent with that of the preceding year.

Toronto, Canada
March 11, 1977

Thorne Riddell & Co.
CHARTERED ACCOUNTANTS

Nine year review

OPERATING RESULTS	1976	1975	1974	1973	1972	1971	1970	1969	1968
Revenue	$ 9,857,976	9,049,127	7,675,886	5,638,451	2,874,153	1,802,992	1,086,782	363,686	71,726
Income (loss) before interest, depreciation and amortization and income taxes	735,490	2,721,141	2,926,111	2,187,633	1,127,819	776,118	328,140	(133,772)	(71,584)
Cash flow	518,391	2,182,108	2,322,431	1,752,494	995,037	647,132	181,192	(155,290)	(74,483)
Profit (loss) for the year	$ (525,925)	$877,943	1,002,059	804,200	451,123	374,520	(9,683)	(251,599)	(90,991)
Earnings (loss) per share — fully diluted	(0.37)	0.60	0.70	0.58	0.37	0.39	0.02	—	—
Shares outstanding at year end									
Class A preferred						60,000			
Class B preferred						60,000	60,000	60,000	60,000
Common	1,407,703	1,402,853	1,359,873	1,359,873	1,169,373	720,450	632,850	358,500	318,750
(Adjusted to reflect 3 for 1 stock split, Nov. 24, 1972)									
BALANCE SHEET DATA									
Total assets	$11,654,879	11,562,067	9,733,249	7,810,424	5,526,962	4,498,034	3,474,391	2,385,670	1,030,441
Long-term debt, net of current portion	3,830,000	2,053,951	2,220,729	2,821,349	1,589,969	1,227,100	509,504	1,085,956	
Deferred income taxes	1,538,133	1,811,583	1,267,098	602,190	154,440				
Shareholders' equity	4,208,222	4,722,397	3,725,879	2,723,820	3,005,284	2,683,958	1,318,277	647,910	821,509